

# Corporate Bribery and Tax Abuse: what's law got to do with it?

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# Corporate bribery and tax abuse: What's law got to do with it?

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As is often the case, we write the title and abstract before we have developed the paper. It came as something of a surprise when I re-read my ambitious plan.

*Using the bifocal lens of bribery and tax abuses, this paper traces the national and international efforts to prevent corporate economic crime. It examines the interplay between the US and UK enforcement and accountability regimes and their relationship with political and economic organisations such as the OECD and the G20.*

I am going to do something rather simpler using the key words 'bribery', 'tax abuse', 'corporate economic crime' but adding the dimension of professional/moral responsibility. Most of the issues here are devastatingly simple at the broad level, but rendered complex and impenetrable in the details by those with an interest in obscuring some underlying truths.

For example I came across an interview about the 'prickly question of tax avoidance' entitled 'Tax avoidance is moral question for clients, not advisors' between a journalist and a tax consultant.<sup>1</sup>

One part of the conversation went like this:

LP: In your opinion, do tax practitioners have a moral duty to at least attempt to interpret [the intention of the legislator]? Or is their role simply to keep their client's tax bill as low as possible, within the law?

RM: My view on tax avoidance is quite simple. It's a moral issue. And I think it's not my moral issue, it's my client's moral issue. I don't try to sell tax schemes to clients but if a client says to me I want a tax scheme, I believe I have an obligation to go and find him one provided you're not overstepping the boundaries of the law. I don't think I'm entitled to say to a client, 'I see what you want as immoral and therefore I'm not prepared to even introduce you to someone who might be able to provide it for you'.

And then he was asked

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<sup>1</sup> Laura Powell: <http://economia.icaew.com/opinion/april-2015/tax-avoidance-is-moral-question-for-clients-not-advisors#sthash.G1mr5tpa.dpuf>

LP: But have you ever been in a situation where your clients' moral compass is vastly different from your own?

RM: No. And if a client wants to do something that's within the law, I believe they are entitled to do it. I've not had a situation where I've had to say to a client 'if you want to do this you're on your own.' Ultimately, I think if we had a tax system that people saw as fair, you'd get less avoidance. If I saw the system as fair, I might be inclined to try and dissuade clients who want to get involved with avoidance. In any event the reality is, most avoidance schemes I've looked at in the last 15 to 20 years didn't look like they'd work. So I tell clients I wouldn't touch them with a barge pole because technically they're not going to work, not because it's a moral issue.

The best estimates tell us that tax abuses are the most significant illicit financial flow out of the developing world, eclipsing the amount of official development aid that is invested in those countries. A recent report from the African Union estimates that the African continent alone is losing roughly 50 billion dollars each year, 20 percent more than the amount of aid coming in. Governments could boost their revenue and economic growth if this outflow through tax evasion, profit shifting by multinational companies, and embezzlement of state funds were stemmed.<sup>2</sup>

In the context of persistent poverty and rising inequality between and within nations, the IBA Task Force on Tax Abuse, Poverty and Human Rights agreed that the fact that tax strategies that produce unfair results may be technically legal is no longer a sufficient justification for their continued use.<sup>3</sup> In the Task Force consultations, some senior members of the legal profession commented on a 'decline in the ethical behaviour of tax lawyers over the last 20 to 30 years. Lawyers used to be much less inclined to go along with abusive schemes. Now they are more willing to give opinions that certain transactions 'have substance' or are 'plausible'. Lawyers have been implicated as intermediaries in cases of tax evasion and other illicit financial flows as a result of attorney-client privilege'.<sup>4</sup>

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<sup>2</sup> [https://www.devex.com/news/remedy-for-a-trillion-dollar-problem-86369?utm\\_source=social&utm\\_medium=twitter&utm\\_campaign=daily\\_post](https://www.devex.com/news/remedy-for-a-trillion-dollar-problem-86369?utm_source=social&utm_medium=twitter&utm_campaign=daily_post)

<sup>3</sup> *Tax Abuses, Poverty and Human Rights A report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights* October 2013

<sup>4</sup> Lloyd Lipsett in *Tax Justice Focus* 2014 Vol 9 no 2. The Task Force conducted stakeholder consultations in the UK, SADC region, Brazil and Jersey.

If we look in more detail we can see the clear connections between corruption, tax evasion, multinational corporations (MNCs) and poverty. In the first part of this paper I give a brief account of the transnational anti bribery movement. This is followed by a discussion of contemporary approaches to tax avoidance. The relevance and role of professional ethics are then considered.

## 1. Transnational Anti Bribery Campaigns

Bribery, tax abuse and money laundering belong to the family of economic crimes. This is recognised in the UK sentencing and deferred prosecution regime although not in the substantive law of corporate liability.<sup>5</sup> Only bribery uses the failure to prevent model of corporate liability. I have recently been involved with the SFO and the MOJ in arguing that they need to be aligned.<sup>6</sup> But that is a different paper.<sup>7</sup>

It is clear that Multinational corporations with their international supply chains provide numerous incentives and opportunities to engage in corruption. Global trade is characterised by complex and circuitous "global value chains" (GVCs). GVCs are "orchestrated for the most part by transnational corporations".<sup>8</sup>

Kevin Davis argues that globalization of the causes of corruption may demand globalization of the institutional responses, .... Recent corruption scandals, from Siemens to Alstom to FIFA, indicate that we may be inching closer to a globalized response - one albeit led by the US.

The kind of enforcement cooperation in major bribery cases we have seen in the last 10–15 years relies on harmonisation of domestic legal systems. The United States lobbied the OECD to develop the 1997 Anti Bribery Convention to bring the rest of the world in line with the US Foreign Corrupt Practices Act. The 40 signatories to the OECD Convention agree to make bribery of foreign public officials subject to criminal or *equivalent* penalties and to the development of liability for legal persons (corporations). The impact of the Convention's rigorous peer monitoring process has been felt not only on the underlying principles of criminal law of its signatories, but also on international

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<sup>5</sup> Crime and Courts Act 2013, s 45 and Schedule 17. See M. Bisgrove and M. Weekes 'Deferred prosecution agreements: a practical consideration' [2014] *Criminal Law Review* 416; <https://www.sentencingcouncil.org.uk/about-us/our-work/fraud-bribery-and-money-laundering/>; see Editorial [2014] *Crim LR* 323

<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/388894/UKantiCorruptionPlan.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388894/UKantiCorruptionPlan.pdf), Action 36.

<sup>7</sup> Celia Wells 'Corporate Failure to Prevent Economic Crime' [2015] *Business Law Review* forthcoming

<sup>8</sup> UNCTAD *GVCs and Development: Investment and Value Added Trade in the Global Economy*, [http://unctad.org/en/Pages/PressRelease.aspx?OriginalVersionID=113&Product\\_x0020\\_Taxonomy=Press Release](http://unctad.org/en/Pages/PressRelease.aspx?OriginalVersionID=113&Product_x0020_Taxonomy=Press%20Release) [Accessed September 17, 2014].

enforcement and cooperation. The UK Bribery Act, said to be one of the world's toughest, would never have happened without the many kicks up the backside given by the OECD.

This is not just about bribery, and not just about criminal law. The FCPA places recordkeeping obligations on public companies which are enforced via a regime of civil penalties.<sup>9</sup> These efforts are underpinned by extensive money laundering provisions. In 2003 the Financial Action Task Force, representing most of the world's financial centres, included 'corruption and bribery' among the predicate offences to money laundering, 'thereby instantly creating pressure for countries to bring their elaborate anti-money laundering regimes to bear against corruption'.<sup>10</sup>

The anti-corruption policies of the international financial institutions include debarment procedures. And an arbitral panel declared that condemnation of bribery is a provision of international public policy that is automatically incorporated into the law that governs private contracts.<sup>11</sup>

## 2. Tax abuse

'But it is all under control now isn't it?' is a common response when I mention tax abuse. The short answer is no. Tax reform is long on rhetoric and short on action.

The IBA Report raises a number of legal and policy questions related to tax abuses, of which the last two are of most significance for this symposium:

- What is the line between legal tax avoidance and illegal tax evasion?
- What types of tax structures and transactions have the greatest impact on the revenues of developing and developed countries?
- What are the most effective reforms required to confront tax abuses?
- What are the responsibilities of states and business enterprises to implement those reforms?
- What is the role of lawyers and the legal profession to confront the challenge of tax abuses?

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<sup>9</sup> 15 U.S.C. § 78m(b)(2)

<sup>10</sup> Financial Action Task Force, 2003. The FATF currently comprises 34 member jurisdictions and 2 regional organisations, representing most major financial centres in all parts of the globe. <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/>

<sup>11</sup> *World Duty Free Company Limited v the Republic of Kenya*, ICSID Case No. ARB/00/7, Award dated 4 October 2006, see 'Bribery and an Arbitrator's Task' by Gary Born, Wilmer Cutler Pickering Hale and Dorr LLP, for WilmerHale <http://kluwerarbitrationblog.com/blog/2011/10/11/bribery-and-an-arbitrator%E2%80%99s-task/>

The slippery boundaries of avoidance and evasion provide fertile ground for suspect schemes. A multinational firm that constructs a factory in a low-tax jurisdiction rather than in the US or the UK to take advantage of low foreign corporate tax rates is engaged in avoidance, whereas a citizen who sets up a secret bank account in the Bahamas and does not report the interest income is engaged in evasion. Many activities, particularly by corporations, that are referred to as avoidance could be classified as evasion. One example is transfer pricing, a type of artificial profit shifting, where firms charge low prices for sales to low-tax affiliates but pay high prices for purchases from them. If these prices, which are supposed to be at arms-length, are set at an artificial level, then this activity might be viewed by some as evasion.

A recent US Congressional Research Paper reports a significant increase in corporate profit shifting over the past several years. Recent estimates suggest revenue losses that may approach, or even exceed, 100 billion dollars per year. And a point that keeps raising its ugly head: hybrid entities, and complex corporate structures are the enablers in this merry go round.<sup>12</sup> And it's not just corporations. Estimates of the cost of individual evasion have ranged from \$40 billion to \$70 billion.<sup>13</sup> Methods used are non reporting plus setting up shell corporations in tax havens.

*What would responsible tax practice look like?*

Action Aid has mapped current proposals,<sup>14</sup> noting that many recommendations for good practice (from all actor groups) share the same basic difficulty: how to draw a clear line between acceptable and unacceptable tax practices. To address this, a small number of sources recommend particular positive behaviours that promote sustainable public revenues and socioeconomic development (i.e. not simply proscribing certain 'bad' practices). This 'may help to move the debate beyond deadlocked disagreement over what behaviour is acceptable or unacceptable.'

The overarching principles identified from a broad range of actors are:

- Transactions should reflect economic substance/commercial reality; no 'artificiality'

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<sup>12</sup> A multinational company subject to corporate income tax in one national jurisdiction that qualifies for tax transparent treatment in another resulting in significant tax savings. This is accomplished when a company is organized as a partnership in one jurisdiction and as a corporation in another. <http://www.businessdictionary.com/definition/hybrid-entity.html#ixzz3c6MMxozt>

<sup>13</sup> The Foreign Account Tax Compliance Act (FATCA) introduced required information reporting by foreign financial intermediaries and withholding of tax if information is not provided. 'These provisions became effective only recently, and their consequences are not yet known.' Jane G. Gravelle Tax Havens: International Tax Avoidance and Evasion Congressional Research Service, January 15, 2015, 7-5700 [www.crs.gov](http://www.crs.gov) R40623

<sup>14</sup> Responsible Tax Planning by Companies, 2015, [www.actionaid.org.uk](http://www.actionaid.org.uk)

- Transactions should respect the 'spirit of law', not just the letter of the law
- No tax planning contrary to intention of legislature/exploiting 'loopholes'
- No 'abusive'/'aggressive' tax planning
- Tax planning should comply with 'generally accepted' practices or 'what tax authorities would expect'

The Report notes that the overarching principles suffer from definitional problems while there is little agreement between different actor groups (MNCs, business federations, NGOs, CSR specialists, etc) on the proscribed behaviours. 'Practices challenged by NGOs are sometimes regarded as 'plain vanilla' or actually incentivised by government policy.' Our tax consultant (above) probably thinks 'vanilla' and 'amoral' are interchangeable. A cited example is the ownership and management of an MNC's Intellectual property by a centralised entity in a low tax jurisdiction.

Only 4 of the 45 sources reviewed consider corporate lobbying for, or use of, tax incentives and exemptions. This is an important area for further thinking given that, particularly in developing countries, the impact of tax incentives on public revenues is likely to be at least as great as (if not greater than) the impact of tax planning practices.

For example, the Action Aid report 'An Extractive Affair' published this month, shows that the Malawi government has lost out on more than US\$43 million in tax to *just one mining company* over the last six years. Malawi is one of the poorest countries in the world. To put that sum in context, in one year that those 43 million dollars could have paid for:

431,000 HIV/AIDS treatments; or 39,000 teachers; or 17,000 nurses, or 8,500 doctors.

In a country where an estimated 910,000 people are living with HIV, mostly women, this lost revenue could have had a huge impact on these people's lives, and their human rights. More than half of this loss was down to the company's use of international tax rules. And it was able to do this, in short, because the international tax system let them.<sup>15</sup>

#### *International tax reform initiatives*

Notably OECD/ G20 BEPS ACTION PLAN and EU CCCTB

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<sup>15</sup> <http://www.actionaid.org/2015/06/exposed-company-dodging-taxes-worlds-poorest-country>

Here we return to the fiction of the 'separate entity' which as Richard Murphy says 'encourages TNCs to create a web of subsidiaries in convenient jurisdictions, inside its own corporate structure, to shuffle profits across borders to suit its tax affairs.'<sup>16</sup>

a. The G20 suggested that this is addressed via the Controlled Foreign Corporation tax base and charged the OECD to look in to this.

This would override the separate entity principle and allow a tax authority to say 'you have that subsidiary in a tax haven: we are going to tax it anyway as a controlled foreign corporation.' But this only works if all major governments sign up.

b. The G20, the rich country club, talks the talk but rarely walks the walk and has been backpedalling from its commitment to the principle that 'profits should be taxed where economic activities deriving the profits are performed and where value is created.'<sup>17</sup> Although the most recent communique talks in optimistic terms about "significant progress on the Base Erosion and Profit Shifting (BEPS) Action Plan", it is not easy to agree.

i. It is vague on deadlines - G20 countries will "begin to exchange information automatically by 2017 or ....by the end-2018, ...subject to completing necessary legislative procedures."

ii. The communiqué makes no reference to the need for transparency in the extractive industries, agreed last year, even though as we know only too well, extractive industries are the most damaging to developing countries.<sup>18</sup> It is their wealth that is being taken. Minerals do not replace themselves.

iii. There is no requirement for companies to make information from a system of automatic exchange available to the public and no reference to the need for country-by-country reporting.

c. The European Commission revealed its Action Plan for Fair and Efficient Corporate Taxation in the EU less than a fortnight ago (17 June)

But again, like the G20, this is long on promise and short on effectiveness. It re-launches the Common Consolidated Corporate Tax Base (CCCTB) 'as a holistic solution to corporate tax reform'.

The flaw in the Action Plan is that it abandons the 'consolidated' bit, the core of the proposal. The UK Treasury has already indicated that it does not accept even this weak Action Plan, as it is fully

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<sup>16</sup> Richard Murphy 'G20: A Commitment to Tax Justice, Sort of' Tax Justice Focus 2014, vol 9 issue 3

<sup>17</sup> Richard Murphy

<sup>18</sup> euractive.com website,



committed to 'tax competition'.<sup>19</sup> Tax competition is very good news for MNCs. It is very bad news for developing countries.

These are political trade offs and then of course there are the regulatory/enforcement trade offs of which the HSBC settlements in Switzerland are a fine example.

The headline figures are these:<sup>20</sup>

- A \$42.8 million dollar fine was imposed by Geneva authorities for "organisational deficiencies" related to money-laundering uncovered in #SwissLeaks. Those deficiencies included reassuring clients that no information would reach their home authorities.
- This contrasts with the more than \$100 billion dollars held in those Swiss leaks accounts.
- 0.04% Fine as a percentage of (revealed) assets under management
- 0.00% Likely deterrent effect

'To put it another way, the fine is about a fifth of the £135 million in tax that HMRC recovered in the UK alone. Even the prosecutor imposing the fine was embarrassed, and "launched a stinging attack" on the Swiss law that apparently prevented anything within yodeling distance of being a deterrent.'

### **3. The professional advisor**

Tax specialists work in something of a regulatory vacuum in which they can be guided by their own moral compass- and we have seen what that means. As David Quentin points out there is a heterogeneous gaggle of lawyers', accountants' and tax advisers' regulatory bodies, many of which regulate professions with a huge variety of other specialisms, and so do not specifically regulate their members in relation to their tax work.<sup>21</sup>

'Some tax practitioners are positively motivated by their self-image as freedom fighters, liberating wealth (which they view as inherently private) from the clutches of the over-mighty state. Others struggle to understand the agency that they and their fellow professionals have in the prior process of structuring transactions so as to be able to claim the consequent dubious tax advantages. They speak as if the legal form that transactions take is deposited overnight by some sort of tax structuring fairy, and that the only role of tax advisers is to wake up in the morning and decide whether or not to claim whatever tax savings arguably arise. Even those who recognise the agency

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<sup>19</sup> <http://www.theguardian.com/world/2015/jun/18/uk-reject-eu-plans-combat-multinational-tax-avoidance>

<sup>20</sup> Source: <http://uncounted.org/2015/06/04/hsbc-money-laundering-and-swiss-regulatory-deterrence/>

<sup>21</sup> David Quentin *Tax Justice Focus* 2014 Vol 9 Issue 3, p.9

of tax advisers in structuring transactions nonetheless insist that their contribution cannot be distinguished from the commercial imperatives of the client.’<sup>22</sup>

It is not just lawyers, #Lux Leaks revealed that PricewaterhouseCoopers [PWC] had negotiated tax rates as low as one quarter of one percent for its corporate clients. A former tax official in the U.S. Treasury explained that ‘a Luxembourg structure is a way of stripping income from whatever country it comes from.’ The Grand Duchy, he said, ‘combines enormous flexibility to set up tax reduction schemes, along with binding tax rulings that are unique. It’s like a magical fairyland.’<sup>23</sup>

KPMG have long been FIFA’s external auditor as well as the auditor of many of the member associations that receive FIFA funding. KPMG was also the auditor and adviser for the official Russia and Qatar organizing committees when they prepared the winning bids that are now targeted in corruption investigations in the U.S. and Switzerland. KPMG continues to support Russia’s organizing committee, while Qatar switched to Ernst & Young in 2011.<sup>24</sup>

Stephen Littler’s research in to CSR policies of the top four accounting firms in the UK shows that tax remains a missing link. Fewer than 20 % gave any account at all of their approach to taxation. Meanwhile, all the reports went into considerable detail about charitable work and links with the community. ‘Given the sheer size of the industry, and the ability for a partner in tax consultancy to earn £3 million per annum in fees, the lack of disclosure of taxation information within accountancy firms’ CSR reports raises serious questions.’<sup>25</sup>

But do lawyers have a choice? What about

*Lawyer/client privilege?*

The concept of attorney–client privilege was raised by numerous stakeholders in the IBA Task Force consultations as being problematic in the context of tax abuses. This nearly sacrosanct principle for the legal profession is embedded in many codes of professional conduct. Nonetheless, questions were raised about the limits to privilege and confidentiality if it is being used to encourage, aid or abet tax abuses or other illicit financial flows.

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<sup>22</sup> David Quentin *Tax Justice Focus* 2014 Vol 9 Issue 3 p.10

<sup>23</sup> Stephen Shay, *News in Brief in Tax Justice Focus*. Lux Leaks 5 Nov 2014

<sup>24</sup> From Francine McKenna: <http://www.taxjustice.net/2015/06/04/did-kpmg-spot-anything-amiss-at-fifa/>

<sup>25</sup> Stephen Littler *Tax Justice Focus* 2014 Vol 9 Issue 3

It was observed that ‘lawyers also have an obligation to keep their clients from getting in trouble with the law. Where was the prudent legal advice to the bankers that are getting in trouble now? Or to the clients that have invested their money offshore?’ Just because something is technically possible does not mean it’s the best strategy to meet your overall objectives. Ending up in court or in the headlines is not likely part of the objectives of the majority of clients.’ There was widespread agreement that lawyers must balance their obligation to defend their client’s interest with the underlying role of the tax system in society.

Enter the UN Guiding Principles on Business and Human Rights - Protect, Respect and remedy- PR2.<sup>26</sup> The American Bar Association (ABA) endorses them acknowledging that they apply to the professional responsibility of lawyers.<sup>27</sup> I have found no such endorsement in either the BSB or SRA Codes of Conduct. Happy to be corrected if I missed it.

The Guiding Principles apply to all business enterprises and therefore apply to law firms and accountancy firms.

The IBA Report suggests that they could be applied to lawyers and law firms in the following ways:

- Law firms should have up-front policy commitments to human rights.
- Merely complying with tax law is not enough when this results in violation of human rights. More than bare legal compliance, lawyers and law firms need to take due diligence measures that allow them to identify, prevent, mitigate and account for how they address their impacts on human rights.
- Responsibility for human rights includes situations where they cause or are associated with third parties’ actions that violate human rights – including by their clients. In such situations, lawyers should use their influence and leverage to encourage their client to not engage in that conduct.
- When tax lawyers are advising a client company to enter into an arrangement that is potentially abusive and will deprive a developing country of tax revenues, this should trigger

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<sup>26</sup>[http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)

<sup>27</sup> Advocates for International Development, ‘Law Firms’ Implementation of the Guiding Principles on Business & Human Rights’, Discussion Paper (November 2011), accessed at: [http://a4id.org/sites/default/files/A4ID%20Paper%20Law%20Firms%20Implementation%20of%20Guiding%20Principles%20Nov%202011\\_0.pdf](http://a4id.org/sites/default/files/A4ID%20Paper%20Law%20Firms%20Implementation%20of%20Guiding%20Principles%20Nov%202011_0.pdf).

See also John Sherman III, ‘The UN Guiding Principles: Practical Implications for Business Lawyers’ (2013), accessed at: [www.hks.harvard.edu/m-rcbg/CSRI/IDQ\\_2013\\_01\\_Sherman.pdf](http://www.hks.harvard.edu/m-rcbg/CSRI/IDQ_2013_01_Sherman.pdf).

a red flag that there is an issue with respect to the UN Guiding Principles, as there may be adverse impacts on human rights. This should provoke a frank discussion between the lawyer and the client about the risks and impacts of the arrangement.

- In complex international transactions, lawyers aren't the only advisers This underscores the importance of having a human rights commitment up front at the level of the legal profession and law firm that clarifies the firm's commitment to human rights to clients from the outset of its retainer. It also poses a practical challenge of having the influence and leverage to get business partners and clients to respect human rights.

The key takeaways from my talk today are these:

1. Bribery and tax abuse contribute to inequality and poverty
2. The separate entity principle and lawyer/client privilege both provide cover for corporate advisors to be complicit in this
3. Lawyers and law firms have responsibilities to respect human rights.